

Order 91-30

National council on compensation insurance ("NCCI") advisory filing -- revisions in existing logging and lumbering classification (code 2702)

August 2, 1991

NOW, on this the 2nd day of August, 1991, this matter comes on before the Commissioner of Insurance for his consideration, pursuant to Ark. Code Ann. ss 23-67-119 and 23-61-303, of an advisory rate filing heretofore made by the National Council on Compensation Insurance ("NCCI") on June 3, 1991, which proposes to eliminate the use of "upset payroll" factors in connection with Code 2702 -- Logging and Lumbering, and which, further, proposes to reduce the Manual Rate for that Code from \$64.24 per one hundred dollars of payroll to \$29.25 per one hundred dollars.

A hearing was held before the Honorable Lee Douglass, Insurance Commissioner for the State of Arkansas, on July 10, 1991. The Petitioner NCCI was represented by its attorney, C. Nicholas Thompson of the firm of Mitchell, Williams, Selig & Tucker of Little Rock, Arkansas. Also present on behalf of the Petitioner was Ken Kennamer, Director -- Government, Consumer and Industry Affairs for the NCCI. Also present was Allan W. Horne, of the law firm of Davidson, Horne & Hollingsworth, P.A. as representative of and counsel for the Arkansas Forestry Association and the Arkansas Timber Producers Association, hereinafter jointly referred to as "Associations" or as "Intervenors." The Insurance Department was represented at the hearing by Jean Langford, Chief Counsel, and Donald K. Switzer, Assistant Commissioner/Compliance. The hearing was concluded and the record closed on July 10, 1991. Based upon the evidence adduced at the hearing, including the testimony given by witnesses and exhibits introduced into the record thereat, the Commissioner FINDS AS FOLLOWS:

1. The Commissioner has personal jurisdiction over the National Council on Compensation Insurance, the Petitioner, and over both the Arkansas Forestry Association and the Arkansas Timber Producers Association, each of which organizations has an interest in the subject matter of this cause and the right to be a party to these proceedings.
2. The Commissioner, further, has jurisdiction over the subject matter of this proceeding under the terms of Ark. Code Ann. s 23-67-119, i.e. an advisory rate filing made by a licensed rate service organization for the benefit of its insurer members or subsidiaries and utilization in the workers' compensation assigned risk plan.
3. The NCCI rate filing was filed with the Department on June 3, 1991, in accordance with Rule and Regulation 23 and Ark. Code Ann. s 23-67-119. Such filing, as permitted by law, specified that it was to become effective July 3, 1991.
4. The NCCI subsequently and on June 6, 1991 amended its rate filing by requesting that the proposed effective date of the filing be postponed from July 3, 1991, to July 15, 1991.

5. Notice of Hearing was given to the Petitioner by letters dated June 7, 1991, from Assistant Commissioner Donald K. Switzer to Ken Kennamer, Director of National Council on Compensation Insurance (received June 12, 1991), and to C. Nicholas Thompson, of Mitchell, Williams, Selig & Tucker (received June 11, 1991).
6. Request for Intervention on behalf of the Arkansas Forestry Association and the Arkansas Timber Producers Association prepared by their counsel Allan W. Horne and purporting to submit an alternate rating proposal for Code 2702 was dated June 20, 1991, and received by the Insurance Commissioner on June 24, 1991.
7. Letters dated July 3, 1991 and July 8, 1991 from C. Nicholas Thompson on behalf of NCCI were received (i) objecting to the intervention of the Associations, and, (ii) requesting a bifurcation of the hearing to consider the NCCI proposal separately from the Associations' proposal, if, in fact, the Insurance Commissioner considered the Associations' submission to be a valid rate filing proposal.
8. Ken Kennamer testified that in Arkansas premium for workers' compensation has historically been derived from either actual payroll or from "upset factors" which were intended to develop an artificial payroll which would reflect the labor cost of producing the wood. Those factors have been set at \$3.40 a cord and/or \$6.00 a thousand board feet for over 20 years.
9. Mr. Kennamer testified that in order for a premium to be adequate it must produce enough money to pay incurred losses. But by reason of the artificially low upset factors, which have not changed in over twenty years and not reflect true labor cost, it was necessary effective March 1, 1991, to raise the Manual Rate for those employers calculating premium on payroll to "\$64.00 and change."
10. With Exhibit No. 9 as an illustration, Ken Kennamer testified that in the period from 1983-1984 to 1987-1988 the payroll base that is reported to the NCCI has shrunk dramatically, while losses reported for the same time period have increased. Losses have increased from \$8,096,495.00 to \$12,847,406.00, while actual payroll has decreased from \$33,029,701.00 to \$17,540,854.00.
11. Ken Kennamer testified that if the use of upset payroll factors was prohibited and the logging and timber production Code 2702 were changed to \$29.25 per \$100.00 of payroll as per NCCI's proposal, an adequate premium would result. He pointed out, too, that in order for the premium to be adequate, the "payroll" would have to be reported on the basis of all recompense or remuneration paid to employees for services rendered, regardless of the form thereof, as required by Rule 5 of the NCCI Manual.
12. That the vast majority of workers' compensation insurance in Arkansas is written in the compulsory assigned risk plan because of the perception within the insurance industry, based upon the reported payroll and loss figures, that the permitted rate level is inadequate and that there is no opportunity to make a reasonable rate of return.

13. While there are some differences in the type of terrain to be encountered, logging operations in Arkansas are not significantly different from logging operations in Mississippi, Oklahoma and Tennessee. Exhibit No. 10 demonstrates that of ten selected southern states only Florida, Louisiana, Mississippi and South Carolina continue, like Arkansas, to utilize an upset payroll factor for calculating premium. And in each instance the factor used is significantly higher than the factor still being used in Arkansas. Where the Manual Rate alone is used, the rates per \$100.00 of payroll range from a low of \$26.84 in Florida to a high of \$38.01 in Tennessee.

14. The NCCI proposed rate for Arkansas of \$29.25 per one hundred dollars of payroll is lower than any Manual Rate currently in use in any of the ten states depicted on Exhibit No. 10 other than for Florida. Ken Kennamer testified, however, that based upon Arkansas experience that rate would be fair and equitable.

15. Ken Kennamer testified that the position of NCCI was that the logging industry was not materially different from other industries that involve high mobility and the use of subcontractors, such as building contractors, plumbers or carpenters -- all of whom have payroll records adequate to serve as a basis for audit and a determination of true payroll, or remuneration.

16. Ken Kennamer also testified that the proposed effective date of July 15, 1991 should not be a significant problem since the new Manual Rate would only apply to new and renewal business thereafter, and, further, any changes in payroll reporting procedure could easily be made by the time of the final audit of the logger employers which would not take place any sooner than one year from the effective date of the rate.

17. Ken Kennamer testified, too, that if the upset payroll factor had increased reasonably over the past twenty-year period, it would not have been necessary to implement the current rate of \$64.24 on March 1, 1991.

18. The NCCI has looked into the possibility of establishing a "mechanized" rate to contrast with a regular payroll Manual Rate but does not now believe there is sufficient actuarial data available to justify it.

19. The Insurance Commissioner takes administrative notice of the NCCI Manual for Workers' Compensation and Employers' Liability Insurance, and, particularly, that portion thereof at Page 5 which recites with that respect to Class 2702 and the upset payroll factors that:

"In all instances where actual payroll records are available, such payroll must be used as the basis of premium."

20. Ken Kennamer further testified that he believed that if the upset payroll factors were abolished in Arkansas and a Manual Rate of \$29.25 established, it would most likely have the effect of opening up the voluntary market in the State and, potentially, result in voluntary market rates lower than \$29.25.

21. Under questioning by Commissioner Douglass, Ken Kennamer testified that from and after December 31, 1990, the NCCI no longer has accepted "vendors policies" under which a number of loggers selling to particular processing facilities could join, or "group" together. As of the hearing date there were some vendors policies in effect, but they were in each instance merely "running off."

22. Ken Kennamer also testified that the group modification factor applied to different groups for experience rating could not be transferred to or carried by the individual loggers who had been in the group. They would have no "mod" at all until their individual experience validated one.

23. Under questioning by Associations' counsel, Allan W. Horne, Ken Kennamer testified that the NCCI had not been able to develop or agree to any grouping concept that would fit within its Manual Rules or its experience rating plan.

24. Ken Kennamer also testified that the NCCI considered "payroll" within the logging industry for purposes of calculating premiums to include monies paid to an employee intended as compensation to the employee for the use of the employee's equipment -- such as a skidder -- in his work task.

25. Testimony on behalf of the Intervenor Associations was given by Mr. Joe Fox of Pine Bluff, Arkansas, who stated that he was vice president of Arkansas Oak Flooring Company, and the current president of the Arkansas Forestry Association.

26. Mr. Fox testified that part of his responsibility for his employer and the Association has been to be involved and informed on matters related to workers' compensation insurance in Arkansas. He advised that, in his opinion, vendors policies had been derived because a number of small logging employers in the State had no payroll records and could not otherwise find compensation coverage.

27. Joe Fox testified that he and the Associations agreed with NCCI that the upset payroll factors currently in use in Arkansas were "woefully inadequate." And he also agreed that all loggers should be paying premium on the same basis; but, knowing that some loggers do not have payroll, in his opinion the best way to "level the playing field" would be to simply establish a Manual Rate based on production stated in tons. Under this proposal the primary processors of wood products in the State would be responsible for determining and reporting the tonnage supplied by each logger, much as they now do for calculation of the severance tax.

28. Mr. Fox's proposal would insure the ability of small loggers who could not afford an individual compensation policy to join a group of similarly situated loggers for compensation purposes. Mr. Fox noted that the severance tax procedure was mandated by statute, but he added, per his calculations, that using the NCCI figures for 1988- 1989 and based on a rate of 55 cents a ton of long wood and 90 cents a ton for short wood, the Associations' proposal would have produced \$13,000,00.00 of premiums, i.e., a sum sufficient to pay the incurred cost of benefits provided.

29. On cross-examination Mr. Fox admitted that neither he nor anyone else in the Associations had to his knowledge, conducted a survey of the logging industry to determine how many logging contractors did and did not have meaningful payroll records. Neither does he know of any other state that calculates compensation premium using "straight tons" as the Associations propose.

30. Joe Fox testified that he believed that loggers were indeed subject to the income tax laws and that someone would have to be generating 1099 Forms and W-2's, but he believed that it was not "fair" to use 1099 gross reporting numbers since much of the money represented fees for the use of equipment, like trucks or skidders, and did not represent true "wages."

31. The Insurance Commissioner takes administrative notice of the provisions of Ark. Code Ann. s 11-9-102(8) which defines "wages" for purposes of the calculation of workers' compensation benefits as follows:

"Wages" means the money rate at which the SERVICE IS RECOMPENSED under the contract of hire in force at the time of the accident including the reasonable cash value of board, rent, lodging or similar advantage received from the employer and including gratuities received in the course employment from others than the employer when gratuities are received with the knowledge of the employer. (emphasis added)

32. Mr. Fox testified that under the Associations' tonnage formula climbing and stumpage service, all left on the ground, would not be weighed.

33. While Mr. Fox said the Associations favored letting a logger coming out of a group taking the group Modification factor with him, he stated that the Associations had done no studies of the matter nor had they developed any statistics.

34. On cross-examination Mr. Fox testified that under the Associations' proposal more premium would be produced from a highly mechanized operation than a less highly mechanized operation -- regardless of the payroll required to produce that tonnage -- meaning, in effect, that the more safe, more fully mechanized operations would pay more in the way of compensation premiums.

35. The Commissioner takes administrative notice of the fact that Rule 9, subparagraph 3(B) of the NCCI Manual provides that: "If investigation on a job site discloses that a definite amount of the subcontract price represents payroll, such amount shall be the payroll for the additional premium calculation. If contracts for labor and material, the payroll shall not be less than fifty percent of the subcontract price. In contracts for labor only, the payroll shall be established at not less than ninety percent of the subcontract price." Further, the Insurance Commissioner notes that the NCCI Manual Rate System under Rule 9 allows sufficient flexibility to assure that premiums be calculated relative only to the compensation for services, determined on a case-by-case basis.

36. House Speaker John M. Lipton announced his support for the tonnage approach to calculating premium as suggested by the Associations and noted that calamity would result from further imposition of the current Manual Rate of \$64.24 per one hundred dollars of payroll.

37. Senators William Moore and James Carroll Scott and Representative John Dawson joined Speaker Lipton and Mr. Fox in decrying the NCCI proposal as unfair to the logging industry and against the best interests of the State.

38. Mr. Robert Levins testified that he is a Field Auditor Supervisor with the Arkansas Forestry Commission and that he is responsible for the collection of Arkansas severance tax on wood products. He indicated his belief that the Commission's enforcement and auditing program was efficient to the extent of being able to collect in excess of 99 percent of the tax due by law. Mr. Levins also testified that he did not believe the Commission would ever be in a position to certify loggers as "mechanized" or not, i.e., to assist in the effectuation of an additional or supplemental Code for logging.

39. Mr. Allen Bedell of Fordyce, Arkansas testified on behalf of the Associations and in opposition to the NCCI proposal to do away with "upset payroll." On cross-examination by Mr. Thompson, Mr. Bedell stated that his company's compensation coverage for his employees was computed on an "upset payroll" basis. He also admitted, however, the authenticity of the Arkansas' compensation claim forms for a James Dwight Peters, one of his employees, which were signed by him and which set forth a \$6.00 per hour payroll rate for purposes of calculation of compensation benefits.

40. Ms. Mary Ann Johnson of Fireman's Fund Insurance Companies testified that she reviewed workers' compensation claim forms from the logging industry and other industries and calculated the benefits due to workers based on percentages of their average weekly wage.

41. On rebuttal the NCCI called Ken Kennamer who testified that he was familiar with the alternative rate proposal of the Associations and disapproved same. He testified that production is not inflation sensitive in the way wages are and cannot respond automatically to changing conditions the way payroll does. He also testified that it would be very difficult to incorporate an experience rating plan into a production-derived formula, and, too, if this special procedure were set up to aid loggers, how could NCCI or the states respond to requests for special treatment by roofers, for example? He stated that payroll is a tried, true and proven system that works in all areas to produce premium adequately and fairly to meet the costs of benefits required.

42. On re-cross examination Mr. Kennamer testified that no state based premiums directly on tonnage produced and that there is a big difference between (a) using an upset or conversion factor to produce payroll (and then premium) and (b) using straight tons to arrive at a premium.

43. Mr. David Parham made a statement on behalf of the Associations' proposal and stated that, as a logging contractor, he made payments to employees and subcontractors and reported that on 1099's -- but he had no way of knowing what portion of the monies paid represented labor or fuel oil, or depreciation or the like.

44. Mr. Ronald R. Lensing spoke on behalf of the Independent Insurance Agents of Arkansas and noted his support for the payroll method of premium computation proposed by the NCCI. He viewed the proposal as being the only rational system to use, in logging or any other industry, and believed that its implementation into logging would bring back the voluntary market, competition, and, ultimately, greater benefit to the logging industry.

CONCLUSIONS OF LAW

1. That the Arkansas Forestry Association and the Arkansas Timber Producers Association are associations with an interest in the subject matter of this proceeding and are entitled to intervene under Ark. Code Ann. s 23-61-305(c) and Ark. Code Ann. s 25-15-202(3).

2. That the upset payroll procedure as set forth for Code 2702 of \$3.40 per cord and \$6.00 per thousand board feet no longer adequately reflects the labor cost of producing wood. Further, the Manual Rate of \$64.24 per one hundred dollars of payroll is excessive and is an integral part of a system that operates at present to produce markedly unfair and discriminatory results.

3. That a pure payroll system is the best means of producing a premium that is fair, and non-discriminatory, and which will produce adequate premium to fund the benefits to be provided.

4. That the "upset payroll" optional method of arriving at payroll has been abused in recent years and, in effect, has created two classes of logging employers, i.e., those that paid voluntarily on actual payroll and those who have used the "upset factors."

5. That wages paid are the basis for the calculation of all benefits under the workers' compensation laws, and the method of producing premium adequate to cover those benefits must, in order to assure equity, and parity, also be based on payroll.

6. That the total amount of compensation paid to an employee or contractor as recompense or remuneration for services is to be considered as "wages" or "payroll" for purposes of the calculation of premium. This is as required by Ark. Code Ann. s 11-9-102 of the Workers' Compensation Code and the principle of compensation law that ". . . wherever allowances of any character are made to an employee in lieu of wages . . . they shall be deemed a part of his earnings."

7. That there is no necessary conflict or inconsistency between: (i) the fact that income taxes are ultimately to be paid upon "taxable income" rather than "gross income"; and (ii)

the fact that workers' compensation premiums must be calculated upon gross recompense for services rendered.

IT IS, THEREFORE, ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

1. That the Arkansas Forestry Association and the Arkansas Timber Producers Association be and they hereby are allowed to intervene as a "party" to these proceedings. And, as parties, under the provisions of Ark. Code Ann. s 23-61-305(e)(2) and Ark. Code Ann. s 23-61-103(b) the Associations shall bear one-half of the cost of the stenographic record. It is further ordered that the NCCI shall pay the other one-half of the cost of such record.

2. The rate proposal as tendered by the Associations is REJECTED and denied inasmuch as the Associations are neither an insurance company nor a licensed rate filing organization.

3. The rate filing of the NCCI for Code 2702 -- logging and lumbering which eliminates the use of "upset payroll" factors and which lowers the Manual Rate from \$64.24 per one hundred dollars of payroll to \$29.25 per one hundred dollars of payroll be and it hereby is APPROVED.

4. The changes in Class Code 2702 including the Basic Manual classification wording and the \$29.25 rate are to be applicable to new, renewal and outstanding policies with effective dates on or after March 1, 1991.

{Footnote 1} For all employers in Class 2702 whose premium has been paid based upon "upset payroll" factors, the NCCI shall provide a two-year transition program before the full implementation of the new Manual Rate aforesaid; such transition program shall be implemented as follows:

A. FIRST YEAR. For renewal policies with effective dates between March 1, 1991 and February 29, 1992, the Manual Rate to be applied to insureds shall be 75 percent of the \$29.25 advisory Manual Rate.

B. SECOND YEAR. For renewal policies with effective dates between March 1, 1992, and February 28, 1993, the Manual Rate to be applied shall be 85 percent of the advisory Manual Rate.

C. THEREAFTER. For all renewal policies with effective dates of March 1, 1993 or thereafter, the full Manual Rate shall be applicable.

6. {Footnote 1} For all employers in Class 2702 whose premium has previously been paid upon the \$64.24 per one hundred advisory Manual Rate shall be entitled to an immediate reduction to the \$29.25 nominal advisory rate and to the same benefits of the transition program set forth in Paragraph 5 as are the employers who are subject of that paragraph.

Lee Douglass
Insurance Commissioner

{Footnote 1} Original text of paragraphs 5 and 6 has been replaced herein per Order 91-30A.
